

The Dragon Awakens

October 13, 2008

William T. Sena

Before a tumultuous crowd last August, the date was 8-8-8, August 8, 2008, the People's Republic of China held a coming out party, and come out they did. Li Ning, the Chinese Olympic champion of 1984, who won six gold medals, in spite of his fear of heights, ran gracefully around the circumference of the Bird's Nest Stadium; yes, he was indeed several hundred feet above the ground as if running on air. But, of course, he was actually suspended by an almost invisible line from somewhere in the sky.

Then YoMing, the 7'5" Chinese NBA star, along with Lin Hao, the 9 year old heroic survivor of the Sichuan earthquake, led the parade of nations into the stadium. As so many of us watched these Olympic events in Beijing unfold, the pageantry, competition, and display of international sporting friendship, hosted elegantly by the Chinese, one had to wonder, "What is this place called the People's Republic of China."

Simply stated, China is the oldest, continuous, major world civilization in existence with records dating back about 3,500 years. However, compared to the Western world, it is a country about which most of us know very little. There were dynasties, the invasions of the Mongol warriors, Genghis Kahn, building the Great Wall, and often times unparalleled world culture. Then, starting in the early 16th century and accelerating through the 19th, Western Europe dominated the economic world and did so in no small part through its colonial policies and productive ability which emerged out of the Industrial Revolution.

During the 19th century, China's political and social cultures weakened and its prosperity diminished. Western thought, industry, and education became preeminent. The Asian countries, many of whom had long been inward looking, deteriorated, perhaps I should say "stagnated." They were easy prey for heavy-handed trading deals backed up by military power, particularly sea power.

During the 20th century after two World wars, practically each of the Asian countries evolved and emerged differently. A few giants like India and Indonesia emerged from their colonial masters in a relatively peaceful manner. Others evolved rather painfully and radically, although securely out of World War II, such as Japan and the Philippines, while China took an entirely different route.

From the early 1900s through 1949, with the Japanese occupation and World War II falling in between, China had a multi-party revolution which was ultimately won by the

Communists under the leadership of Mao Zedong.

From 1949, with the creation of the People's Republic of China, through 1976 with the death of Mao, the Party under Mao viciously destroyed virtually all of the economic and cultural institutions which had existed in China for the past 3,000 years. Tens of millions of the Chinese were killed, died of starvation, or were purged during the Mao years. Unbelievably, practically all property was seized and taken into State ownership. As the United States stepped onto the global scene as a superpower after World War II, contemporary China became more well known and unknown, all at the same time, and as such, greatly feared. The headlines were always Mao this or that, Chiang Kai-shek, Madam Chiang Kai-shek, Korea, the North Koreans, five-year plans, the Great Leap Forward, and the Cultural Revolution. Behind these headlines was a bamboo curtain with little real information filtering through and a great deal of mystery.

Back in the early part of the 19th century as China was deteriorating under a series of emperors and empresses, Great Britain established a trading port which became known as Hong Kong. It was taken, negotiated for, or fought for during the early part of the century and then fairly firmly established in 1842. In 1899, as a concession coming out of the Boxer Rebellion, Great Britain negotiated a 99 year lease on this colony. While Hong Kong was a trading port for almost 200 years, it also evolved during the second half of the 20th century as the "door" to the Mainland with information and commerce flowing from China to the rest of the world through it. In 1998, Hong Kong was, as they then said, "handed over" to the People's Republic of China upon the expiration of the lease.

This tiny colony developed a very significant economic position as the main financial center of Southeast Asia, a major outlet for Chinese manufactured goods, and practically the only window to the Mainland during the Mao years. By the 1990's, the Hong Kong stock market was the largest in Asia, next to Japan. It was an active and orderly financial window to Mainland China for investors worldwide.

With the death of the old Party leadership of Zhou Enlai and Mao Zedong in the mid 1970s, followed by a half dozen years of infighting and power struggles within the Gang of Five and the Chinese Communist Party, a constitution was actually created under a new and relatively unified leadership. This brought great improvement in the governance and standard of living to the vast population. A move toward real land reform and private ownership began to take seed. In 1987, Vice-Premier Deng Xiaoping made the now famous speech which included the words, "go forth and prosper, it is good to be rich!" Whatever

the translation, whatever the interpretation, the inference was widely understood and readily accepted. Deng unleashed a pent up China on virtually every front. But how did this actually happen?

Let's examine three key ingredients which were in place at that time, each of which was briefly discussed earlier. First, China was the largest country in the world in terms of population and occupied a large and well-endowed piece of geography. The culture, learning, and ability of the people were and are substantial. China, with its position of power and culture, was known throughout hundreds of years as "The Middle Kingdom."

Second, during the first three-quarters of the 20th century the revolution, then communist rule under Mao Zedong, the culture and traditions of the past 3,000 years changed substantially. The Communist Party, that is the State, seized and virtually owned every business, property, and industry in this giant country. China was savagely forced into the 20th century by Mao and the Party.

Third, the tiny port, colony, or country of Hong Kong existed as a window to the West and as a financial powerhouse. It was scheduled to become part of China in 1998, although how and through what process was still quite up in the air in the early 1980s.

Most countries faced with a situation of this nature would have been enormously "befuddled," needless to say. The years of isolation and State control created several generations of a fearful and cautious people, hardly entrepreneurs. However, this change in the late 1980s was not a "revolution" *per se* as the State was still controlled by the Communist Party. It, the CPC, was in fact going to orchestrate the changes, approve of goings-on, or at least not object. Many within China and practically every other nation in the world feared this change or experiment as so much of China and the generations under Mao's rule had known nothing but revolution, a communist and socialistic state, and collectivism, all of which had failed. Just what would move in to replace it?

Like it or not, the move from State-owned enterprises (SOEs as they were and are called) to private ownership or capitalism was in the works. Nothing of this nature on this scale had ever before been done in history. Few believed it could really happen, much less, in hindsight, how it actually evolved.

Let me tell a story or scenario about which I heard and discussed on one of my trips in the mid 1990s to China. The biggest, most important political and economic entity in China since 1949 was the People's Liberation Army, the PLA. It had the largest budget, controlled most of the major industries, and was, needless to say, very, very powerful.

Barter was often the means of transaction for the Army. For instance, the Shanghai Tank and Motor Brigade manufactured jeeps, trucks, and tanks, along with all kinds of other motor vehicles. The Guangdong Quartermaster Corps manufactured uniforms, soft goods, and furniture. The Harbin Munitions Division manufactured armaments, chemicals, and hard goods. Shanghai often traded trucks and jeeps to Guangdong and Harbin in exchange for uniforms and munitions. And, of course, the senior military staff was in charge of each respective division, pretty much running a business.

With the changeover to something resembling a mercantile environment, the Shanghai Motor Brigade entered into a partnership with Volkswagen to begin manufacturing automobiles. The State and the Generals owned part of the company and Volkswagen owned the other part. The Guangdong Quartermaster Corps entered into partnerships with firms like Nike or Hilton Hotels to begin manufacturing consumer goods and run a lodging industry. These were not public companies *per se*, but they were moving in a direction of private enterprise and the Generals were the first persons to "get rich," as suggested by Deng Xiaoping. Sometime thereafter, smaller enterprises sprung up around these companies and began to manufacture other goods to trade with the Shanghai/Volkswagen partnership as well as the Guangdong/Nike partnership. From each of these the leap to global commerce was a natural next step. The corridor in Guangdong Province running from the new city of Shenzhen to the trading port of Hong Kong emerged as a global economic state with world class soft goods and electronic component businesses which became some of the largest in the world. Many were financed by Hong Kong and Western commercial interests through that window to the West.

The same shift in former State-owned enterprises began to emerge all over the country. The former managers of these enterprises and businesses became partial owners of the companies and learned entrepreneurship. It was an enormous change for the people as they had pretty well been dealing with a "command economy" as opposed to one driven by supply and demand, which was the model in the West.

As a result of these moves, massive changes were underway in China and the life of its people. Factories were built, the rural population moved to the cities in quest of work, and thus created a demand for housing and services. An industrial revolution, like that which took place in Europe in the 19th century, was well underway.

Hong Kong prospered enormously as did the entire region of Southeast Asia. Bear in mind, however, that South Korea, Taiwan, and Singapore were already well-established

commercial states, and, in fact, each of them had a relatively active stock market with worldwide investment interest. However, the question still hung out there, "what would happen in China?" There was talk that Great Britain would try to keep control of Hong Kong in 1997, that the "get rich scheme" would fail, the peasants would revolt, and the government would "crack down." Then came the Tiananmen Square incident which took place in 1989 giving fuel to this fear in the West. Such fear, however, as tragic and dastardly as Tiananmen was, turned out to be relatively unfounded and was relegated to a place in the history of uprisings put down.

Commerce and trading activity continued to grow in China, in fact exploded on the upside and with it a full new world of prosperity for a significant portion of the Chinese population. Local stock markets came into being in Shanghai, Beijing, and Shenzhen by the mid 1990s. Most of the publicly traded companies, or somewhat publicly traded companies, were small, newly established, or a floating of a small portion of shares in the State-Owned Enterprises. There were restrictions on who could buy shares; in many cases only Chinese citizens. Western commercial and investment banks, particularly those of the United States and Great Britain, established offices in the PRC and expanded their Hong Kong offices.

The West, principally speaking about Europe and the United States, became cautiously pleased and cooperative with the opening of China and the development of trade. The system or form of government in China was not and is not particularly to the liking of the West. China is far, far from a democracy. Looking back, however, the system of ruling China has evolved in a rather interesting and even predictable manner from an historical and political point-of-view. The country long had emperors and war lords. Today it is or continues to be an autocratic and authoritarian system. Power and authority are exercised in a small pyramidal structure, an oligarchic form. The name given to this oligarchy is the Chinese Communist Party. But, as such, it is communist only in name and that being a carryover from Mao and the Revolutionary days. It could just as easily be called the Guardians coming out of Plato's Republic. Over the three millennia of Chinese history, an authoritarian system is all that has ever existed, it has been the rule. In fact, the Chinese Communist Party may be more of a sharing of power among its oligarchic rulers than were the emperors.

We tend to view democracy and capitalism as partners in prosperity and general well being. Thus, the Chinese form of authoritarianism appears to be incompatible with

capitalism, public shareholder ownership, and private property rights. Conversely, our form of democracy, and that of Western Europe, appears to be incompatible and unacceptable to the Chinese. They tend to believe in the superiority of the common or community rights, subordinating individual rights to the greater community. Perhaps the size of the population, just feeding itself, and maintaining order dictates such. Another part of this may be a cultural issue. Think for a moment about Chinese character writing, how unique it is, and the story it tells. As we know, it is very difficult to read or understand the Chinese language. On the other hand, English is widely used in China.

I had an experience in 1998 in Urumqi, a fairly large city in northwestern China, much like Denver, a city on the high plateau with minerals, mining, and oil production. My wife and I were there with a small group of people traveling some of the outer regions. One morning I awoke early and took a stroll to a nearby park along the river which ran through the town. A group of young school children were waiting outside the park to enter. It was springtime and they were there on some sort of school outing. These were bright-eyed, attractive children, dressed in uniforms, white or blue shirts, khaki trousers or skirts, and the like. As I waited to enter the park at the 9 o'clock opening, a number of these children looked at me and laughed at seeing an American up close. Many approached saying, "Hi, how are you?" Then they ran away. I spoke back to them in English. They all laughed again and began to try to say something else to me in English. I subsequently found out that these children in Urumqi, a city 2,000 miles from Beijing, were taught English as the mandatory second language in the primary school system.

From then through the present, I have come to understand that English is indeed the second language of China, not French, Spanish, or Japanese. The street signs in Beijing, the capital and a formerly hard-line city, are in Chinese and English. Virtually all of the menus in restaurants are in Chinese and English. Commercial goods and companies' names on banners are in both languages. On a recent trip I found that one-third of the entrance exam for a Chinese university is proficiency in English. I doubt that even 1% of the students in the United States study Chinese or would even consider doing such. Our inability to speak or understand the Chinese language, and coming from the language, the culture, is significant and will ultimately be a competitive disadvantage. In net effect, they will know all there is to know about us, be able to read everything we write, and we will only know about them what they wish for us to know through translation. This is an unfortunate shortcoming for Americans, and one I fear.

This reminds me of a local story about which I've heard, only second-handedly, but from enough reliable people, that I believe it to be pretty accurate. Back in the late 60s there was a Chinese exchange student enrolled at the University of Cincinnati. He was apparently a very bright and affable young man, and after the first semester, decided to become involved in fraternity life. This young man whose name was Peter, pledged the Sigma Chi fraternity at UC. He didn't have a great deal of money, so his fraternity brothers, after initiation, allowed him to live in the Sigma Chi house in exchange for doing some of the housekeeping tasks. Peter graduated with his class and everyone had a rousing party at the end of the senior year. Peter went back to Hong Kong. He did, however, maintain contact with a number of his fraternity brothers and classmates. About 10 to 15 years after graduation he invited some of his closest friends to attend his wedding in Hong Kong. Thus, a group of guys from the University of Cincinnati flew to Hong Kong in the mid-1980s to attend a wedding. Much to their surprise they were greeted at the airport by a fleet of Rolls Royces, and thinking they were being taken to hotel, they were quite pleased. However, this fleet of luxury cars dropped them at Peter's home which was on the top of the mountain. That's a very special place in Hong Kong. It turned out that their classmate was none other than Peter Wu who was now the chairman of Wharf Holdings Company, one of the seven Hongs. His father, grandfather, and probably great-grandfather were chairpersons of this great trading company for generations in the past. Peter Wu is one of the wealthiest men in the world and he learned his English right here in Cincinnati!

I am inclined to liken the growth of the Chinese economy and markets to be similar to that of the United States in the period from 1865 through 1910. It was a wild time of boom and bust, robber barons and market scandals, urbanization and prosperity. However, rather than taking 50 years, all of this seems to have been done in China in 10 to 20 years. For a while now, the Chinese economy has been growing at the astronomical rate of over 10% per year. It will undoubtedly slow down, but that might be to "only" 5 to 7% per year, still very rapid.

The Olympics were indeed a "coming out party" for the new China. But, while all appears to be moving forward, China's economy and social structure can be quite turbulent below the surface. Their political leaders do not hesitate to infer that the economic growth is unsustainable but that they will continue to grow and attain a position of global economic authority. The rise in commodity, raw material, and energy or oil prices earlier this year was particularly hurtful to the Chinese economy and drove their inflation rate to an

uncomfortably high level. The Chinese Central Bank has taken steps to address these questions as the problems of jobs, growth, and prosperity are similar to those of the West, even though the economic policy debate is not necessarily shared publicly nor does popular opinion carry much weight.

As noted in a recent *Wall Street Journal* article, the Central Bank of China said, our "authorities have already drawn up plans to avoid and reduce the impact of the U.S. financial crisis on China... We have the confidence, means and ability to maintain China's economic development and financial stability and contribute to the stable development of the world economy." In fact, the current credit crisis in much of the world has not affected domestic China. It is, as we have noted, an autocratic society.

What does the future hold for China? Much has been written during the past few years by men and women far more scholarly and politically savvy than I, so my predictions or thoughts on the future course of China may be simplistic. Nonetheless, some simple observations.

I believe that there are three drivers or pieces of the puzzle in the China story which are yet to fall into place.

First, there is the huge, aggressively and dynamically growing Chinese economy, which growth or development I would guess to be about 40 to 50% complete. For instance, 25 years ago only 10% of the population lived in the cities. Today, 40 to 50% are city dwellers. The coastal areas are much more developed than the interior, but, as economic development continues, that is also changing. Technology is mixed, there is little healthcare or social benefits as we know them, and some of the well known problems such as environmental quality standards, patent protection, and working conditions are substandard. Thus, development is but half complete. It will indeed go on, it is being driven by the Chinese people and their culture.

Second, the United States in particular and Western Europe and Japan to a lesser extent, have a huge edge in science and technology. While China and other parts of the developing world have benefited from these technological developments, they have not invented or created them. The question is when, not if, China will move toward educational parity and overall scientific or inventive leadership. Just look at the makeup of the student population at MIT or Stanford.

Third, how will the tradeoff in the huge population evolve. On one hand there is, I should think, a population "economy of scale" in practically every endeavor that China undertakes, particularly with a strong national government to direct or mandate such. The Olympics were a very good example of this. Conversely, will China's huge population have a crippling effect with the number of people so large and concomitant problems just so big that they are insoluble? Bear in mind, however, that the Chinese population is 90% Han. This huge country is virtually a single ethnic group, and that ethnic group is both hardworking and well learned.

I would like to end with a couple of quotes from the *Foreign Affairs* journal of July/August 2008, an article by Fred Bergsten: "To be an economic superpower, a country must be sufficiently large, dynamic, and globally integrated to have a major impact on the world economy. Three political entities currently qualify: the United States, the European Union, and China." And then, also from the *foreign Affairs* journal a short quip, "At one particularly contentious point in the negotiations to enter the WTO (the World Trade Organization), the Chinese ambassador reportedly thundered, 'we know we have to play the game your way now, but in 10 years we will set the rules.'"

Yes, the dragon has awakened; we need only recall Napoleon's words, "Let China sleep, for when she wakes, she will shake the world."